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No. 97-2045

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

SOUTH CENTRAL BELL TELEPHONE COMPANY, *et al.*,
Petitioners,

v.

STATE OF ALABAMA AND
STATE DEPARTMENT OF REVENUE,
Respondents.

On Writ of Certiorari to the Supreme Court of Alabama

BRIEF FOR PETITIONERS

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QUESTIONS PRESENTED

1. Whether the Alabama Supreme Court, following the same practice that this Court condemned in *Richards v. Jefferson County*, 517 U.S. 793 (1996), deprived petitioners of the due process of law guaranteed by the Fourteenth Amendment by barring them from presenting a federal constitutional challenge to a state tax on the theory that petitioners were bound by a prior state-court judgment in a case to which they were not parties, in which they were not represented, and of which they had no notice.

2. Whether Alabama's franchise tax impermissibly discriminates against interstate commerce, in violation of the Commerce Clause, by taxing Alabama corporations only on the par or stated value of their stock (the amount of which is determined solely by the corporation itself) while taxing out-of-state corporations on the actual value of essentially all their capital employed in Alabama, with the demonstrated result that Alabama corporations on average pay less than one-fifth of the franchise tax they would pay if they were incorporated outside Alabama.

PARTIES TO THE PROCEEDINGS

The following list identifies all parties to the proceedings in the Alabama Supreme Court:

State of Alabama, State Department of Revenue
South Central Bell Telephone Company
BellSouth Telecommunications, Inc.
BellSouth Corporation
BellSouth Services, Inc.
BellSouth Financial Services Corporation
BellSouth Advertising & Publishing Corporation
BellSouth Resources, Inc.
BellSouth Products, Inc.
Alabama Cellular Services, Inc.
CSX Transportation, Inc.
Seaboard Coastline Railroad Company
Louisville & Nashville Railroad Company
Seaboard System Railroad, Inc.

Pursuant to Rule 29.6 of the Rules of this Court, petitioners state the following:

South Central Bell Telephone Company and BellSouth Services, Inc., are predecessors of BellSouth Telecommunications, Inc. Effective July 31, 1998, BellSouth Financial Services Corporation was merged into BellSouth Communication Systems, Inc., an indirect, wholly owned subsidiary of BellSouth Corporation. Each of BellSouth Telecommunications, Inc., BellSouth Advertising & Publishing Corporation, BellSouth Resources, Inc., BellSouth Products, Inc., and Alabama Cellular Services, Inc., is (directly or indirectly) a wholly owned subsidiary of BellSouth Corporation. These filers' non-wholly owned operating subsidiaries are:

1155 Peachtree Associates
Infoventures
Infoventures of Atlanta
Beijing Ji Tong—BellSouth Communications & Information Engineering Company, Ltd.

Compania de Radiocomunicaciones Moviles S.A.
Otecel S.A.
Telcel Celular C.A.
Tele 2000, S.A.
BellSouth Wireless Data, L.P.
RAM Mobile Data Belgium, S.C.S.
RAM Mobile Data C.V.
BellSouth Carolinas PCS, L.P.
Bloomington Cellular Telephone Company
Chattanooga MSA Limited Partnership
Decatur RSA Limited Partnership
Florida RSA #2B (Indian River) Limited Partnership
Georgia RSA No. 1 Limited Partnership
Georgia RSA No. 2 Limited Partnership
Georgia RSA No. 3 Limited Partnership
Gulf Coast Cellular Telephone Company
Jacksonville MSA Limited Partnership
Lafayette MSA Limited Partnership
Los Angeles Cellular Telephone Company
Louisiana RSA No. 7 Cellular General Partnership
Louisiana RSA No. 8 Limited Partnership
MCTA
Memphis SMSA Limited Partnership
Muncie Cellular Telephone Company, Inc.
Orlando SMSA Limited Partnership
Richmond Cellular Telephone Company
Tennessee RSA Limited Partnership
Terre-Haute Cellular Telephone Company, Inc.

CSX Transportation, Inc., is a wholly owned subsidiary of CSX Corporation. Seaboard Coastline Railroad Company, Louisville & Nashville Railroad Company, and Seaboard System Railroad, Inc., are each predecessors of CSX Transportation, Inc. CSX Transportation, Inc.'s non-wholly owned subsidiaries are:

Akron Union Passenger Depot Company
Allegheny and Western Railway Company
Augusta and Summerville Railroad Company

Baltimore and Cumberland Valley Rail Road Extension Company
Beaver Street Tower Company
Central Transfer Railway and Storage Company
Chatham Terminal Company
Cleveland Terminal & Valley Railroad Company
Dayton and Michigan Railroad Company
Distribution Services, Inc.
Energy Dominion
Gemetal Distribution Services, Inc.
Georgetown Potomac Company
Harbour Associates
Helm-Atlantic Associates, L.P.
High Point, Thomasville & Denton Railroad Company
Home Avenue Railroad Company
Independent Rail Services, Inc.
Indiana Rail Road Company
Lakefront Dock and Railroad Terminal Company
Mahoning State Line Railroad Company
Midland United Corporation
North Charleston Terminal Company
One James Center Associates
Richmond Center Associates
Richmond Center Associates II
Savannah Harbor Resort Developers, LLC
Savannah Harbor Venture Partners, LLC
SHRD, Inc.
Unified Services, Inc.
Washington Harbour Associates Limited Partnership
Winston-Salem Southbound Railway Company
Woodstock & Blocton Railway Company

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BRIEF FOR PETITIONERS

OPINIONS BELOW

The order and accompanying opinions of the Supreme Court of Alabama (Pet. App. 1a-14a) are reported at 711 So.2d 1005. The opinion of the Fifteenth Judicial Circuit Court of Montgomery County, Alabama (Pet. App. 15a-22a) is unreported.

JURISDICTION

The Supreme Court of Alabama entered its judgment on March 20, 1998. The petition for a writ of certiorari was filed on June 18, 1998, and was granted on September 29, 1998. The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1, provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law."

Relevant portions of Alabama statutes, regulations, and rules are set forth at Pet. App. 76a-110a.

STATEMENT

Although Alabama imposes a corporate franchise tax on all corporations, the tax on out-of-state corporations differs significantly from the tax on in-state corporations. The State taxes domestic corporations based on the par value of their stock—an amount that state law permits domestic corporations to set as low as they choose. Alabama corporations can therefore limit their franchise tax liability to a minimal amount simply by reducing their stock's par value. By contrast, Alabama taxes out-of-state corporations based on the "actual amount of [the corporation's] capital employed" in Alabama—an amount that a corporation cannot manipulate through an artificial adjustment to the par value of its stock. This disparate treatment of in-state and out-of-state corporations discriminates against interstate commerce, both facially and in effect: Alabama corporations on average pay less than one-fifth of the franchise tax they would pay if they were incorporated outside of Alabama.

Petitioners (all of whom are incorporated outside of Alabama) challenged Alabama's franchise tax in Alabama

state court. The Alabama trial court, though expressly determining that the franchise tax is unlawfully discriminatory under this Court's Commerce Clause precedents, nevertheless denied relief. Invoking state-law principles of "res judicata," the trial court ruled that petitioners' challenge was barred by a 1989 state-court judgment upholding the franchise tax, even though that judgment had been entered in a case to which petitioners were not parties, in which they were not represented, and of which they had no notice. On appeal, the Supreme Court of Alabama—in a five-to-four decision, and over a vigorous dissent—affirmed without opinion.

The Alabama Supreme Court's judgment is incompatible with this Court's controlling constitutional rulings. *First*, just two years ago, in another state tax case from Alabama, this Court ruled that the Alabama Supreme Court could not, consistent with the Due Process Clause of the Fourteenth Amendment, "bind a litigant to a prior judgment to which he was not a party." *Richards v. Jefferson County*, 517 U.S. 793, 805 (1996). That rule "clearly applies," the Court held, "when a taxpayer seeks a hearing to prevent the State from subjecting him to a levy in violation of the Federal Constitution." *Id. Second*, there can be no doubt, particularly after this Court's decision in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), that Alabama's discriminatory franchise tax scheme violates the Commerce Clause. The Alabama Supreme Court, in default of its constitutional responsibility, simply defied these controlling decisions.

1. *The Tax at Issue.*

Under Alabama law, a domestic corporation (*i.e.*, a corporation organized under the laws of Alabama) must pay a franchise tax "based on its capital stock" at the rate of $10 per $1,000 of capital stock. Ala. Code § 40-14-40.[1] Although the statute does not define "capital

[1] Prior to 1984, the rate was $3 per $1,000 of capital stock. *See* Statement of the Facts (hereinafter "Statement") 11 n.18, 18

stock," Alabama has long equated "capital stock" with the aggregate of the par value of the corporation's stock. *See* Stipulated Facts (hereinafter "Stip.") ¶¶ 9, 17, 56 (Pet. App. 50a, 52a, 61a); *see also White v. Reynolds Metals Co.*, 558 So.2d 373, 375-80 (Ala. 1989), *cert. denied*, 496 U.S. 912 (1990); Br. in Opp. 3-4; J.A. 32, 143-46, 150, 154, 161-64, 171, 175. In the case of stock without par value, Alabama applies the term "capital stock" to mean the stock's "stated value." *See* Stip. ¶¶ 9, 17 (Pet. App. 50a, 52a).

The par or stated value of a domestic corporation's stock is determined by the corporation itself and does not represent the stock's market or book value. *See* Stip. ¶¶ 19-24 (Pet. App. 52a-53a). As the parties stipulated, an Alabama corporation "may control the amount of its domestic franchise tax . . . by assigning as the 'par value' or 'stated value' of its capital stock any value selected by it." Stip. ¶ 21 (Pet. App. 52a); *see also* Statement 17 (Pet. App. 30a); J.A. 36-37, 145, 154, 163, 175. Consequently, domestic corporations can (and do) limit their franchise tax liability to a minimal amount by assigning to their stock only a token par or stated value (for example, one cent per share). *See* Stip. ¶¶ 21-24 (Pet. App. 52a-53a); Statement 17 & n.20, 38 (Pet. App. 30a, 46a-47a); J.A. 76-77, 110-11. State law fixes the minimum franchise tax liability for domestic corporations at $50 annually, *see* Ala. Code § 40-14-40; the vast majority of Alabama corporations pay only this minimum amount, *see, e.g.*, Rec. 1329-69.

A foreign corporation's franchise tax liabilty is computed on a different basis. A foreign corporation must pay a franchise tax at the rate of $3 per $1,000 of "the actual amount of [the corporation's] capital employed in

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(Pet. App. 24a, 27a). The years at issue in this case include 1982 through 1991. *See* Pet. App. 16a n.3. The "Statement of the Facts" is a portion of petitioners' pretrial brief that the trial court adopted in full as its own. *See id.* at 21a n.7.

this state." *See* Ala. Code § 40-14-41(a).[2] The statute defines a foreign corporation's "capital" to comprise not only "capital stock" (the sole basis for the domestic franchise tax), but also essentially every other item of capital reflected in the corporation's balance sheet, including "surplus and undivided profits, long-term debt, certain related party debts and accelerated depreciation." Stip. ¶ 18 (Pet. App. 52a); *see* Ala. Code § 40-14-41(b)(1)-(5). A foreign corporation, unlike a domestic corporation, thus cannot control its own franchise tax liability by adjusting the par or stated value of its stock. *See* Stip. ¶¶ 25-26 (Pet. App. 53a); J.A. 37-38.

In sum, despite a nominally higher franchise tax rate for domestic than for foreign corporations ($10 per $1,000 of "capital stock" vs. $3 per $1,000 of "capital employed" in Alabama), and despite the inability of domestic corporations to apportion their tax base (the tax applies to the corporation's stock regardless of where it does business), Alabama empowers domestic corporations (but not foreign corporations) to reduce their franchise tax burden to a *de minimis* amount by adjusting the par value of their stock. The demonstrable result, as explained below, is that foreign corporations bear a vastly disproportionate franchise tax burden solely because they are organized under the laws of States other than Alabama. *See infra*, pp. 9-10.

2. *The Reynolds Litigation.*

In 1986, two out-of-state corporations, Reynolds Metals Company and General Motors Corporation, brought suit in Alabama trial court, claiming that Alabama's franchise

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[2] A corporation's capital "employed in" Alabama consists of an apportioned share of its total capital, as determined by the percentage of the corporation's total property, payroll, and sales attributable to Alabama. *See generally* Ala. Code § 40-14-41(c); Ala. Franchise Tax Reg. § 810-2-3-.11 (repealed in 1992 and replaced by comparable provisions in Ala. Franchise Tax Reg. § 810-2-3-.13 (1993)).

tax scheme violated (among other things) the Commerce and Equal Protection Clauses of the United States Constitution. Reynolds and GM argued that, because of the different tax bases used in Sections 40-14-40 and 40-14-41, Alabama's franchise tax scheme discriminated against out-of-state corporations. Proceeding on summary judgment and without a fully developed record, Reynolds and GM supported their discrimination claim by pointing to evidence that the average out-of-state corporation paid significantly more franchise tax than the average Alabama corporation.

The trial court agreed that Sections 40-14-40 and 40-14-41 discriminated against out-of-state corporations. Noting that, in 1982 and 1983, Alabama had collected almost $94 million from 29,000 out-of-state corporations but less than $10 million from 82,000 Alabama corporations, the trial court granted summary judgment for the plaintiffs on the ground that the franchise tax scheme violated the Equal Protection Clause. *See Reynolds Metals Co. v. White*, No. CV-86-1093, slip op. at 3 (Montgomery County Cir. Ct. July 7, 1989).[3] The Alabama Court of Civil Appeals affirmed in all respects. *See White v. Reynolds Metals Co.*, 558 So.2d 367 (Ala. Civ. App. 1989).

Just seven days after the Court of Civil Appeals rendered its decision, however, the Alabama Supreme Court, acting *sua sponte*, issued a writ of certiorari, ordered the parties to file briefs within three days, and scheduled oral argument on the third day after that. Ten days after oral argument, the court issued a decision upholding the franchise tax in all respects. *See White v. Reynolds Metals Co.*, 558 So.2d 373 (Ala. 1989), *cert. denied*, 496 U.S. 912 (1990).

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[3] In light of its equal-protection holding, the court found it unnecessary to address the *Reynolds* plaintiffs' Commerce Clause claims. *See* slip op. at 2.

In rejecting both the Commerce Clause and Equal Protection Clause attacks on the franchise tax, the Alabama Supreme Court proceeded on the premise that "the ultimate question in applying either equal protection or commerce clause analysis to these facts is virtually the same." *Id.* at 382. That question, the court said, was "whether the franchise tax on foreign corporations *invidiously* discriminates against them by imposing a grossly disproportionate tax on them for no other reason than to provide a competitive advantage to domestic corporations." *Id.* (emphasis in original). "[I]n enacting tax statutes," the court stated, "legislatures are not required to reach equality with mathematical precision." *Id.*

Applying these standards, the court pointed to two considerations that, in its view, reduced "the alleged unequal treatment of and discrimination against foreign corporations . . . to a point that no discrimination of constitutional significance exists." *Id.* at 388. *First*, the court said that the plaintiffs had failed to make a sufficient factual showing of discrimination to support their motion for summary judgment—or, indeed, to withstand the State's cross-motion for summary judgment. In the court's view, plaintiffs' summary showing that the average foreign corporation paid more franchise tax than did the average domestic corporation did not necessarily prove discrimination. The higher tax burden on foreign corporations would not be discriminatory at all, the court reasoned, if foreign corporations employed more capital in Alabama than domestic corporations—a question that could not be answered on the record compiled in the case. *See id.* at 383.

Second, the court determined that the foreign franchise tax could in any event be justified under the "complementary tax" doctrine as a levy designed to compensate for the combination of both the domestic franchise tax *and* the State's "domestic shares tax" (Ala. Code § 40-14-70)—an unrelated *ad valorem* property tax im-

posed on shareholders of domestic corporations but, in practice, usually paid by corporations on behalf of their shareholders (*see id.* §§ 40-14-70(c), 40-14-73). *See* 558 So.2d at 384. Adding the domestic shares tax to the domestic franchise tax, the court stated, made the relative tax burdens on domestic corporations "more nearly equivalent to that of foreign corporations." *Id.* at 386. The court neglected to mention that Alabama law also imposes an *ad valorem* shares tax on Alabama residents owning stock in foreign corporations. *See* Ala. Code § 40-11-1(b)(9).

The *Reynolds* decision predated this Court's recent decisions expressly rejecting "a 'de minimis' defense to a charge of discriminatory taxation under the Commerce Clause," *Fulton Corp. v. Faulkner*, 516 U.S. 325, 334 n.3 (1996), and narrowly circumscribing the scope of the "complementary" or "compensatory" tax doctrine, *see id.* at 333-44; *Associated Indus. of Missouri v. Lohman*, 511 U.S. 641 (1994); *Oregon Waste Sys., Inc. v. Department of Environmental Quality*, 511 U.S. 93 (1994).

3. *The Proceedings Below.*

a. Trial court. While the *Reynolds* case was pending before the Alabama Supreme Court, petitioner South Central Bell Telephone Company (which later became BellSouth Telecommunications, Inc.) brought this action challenging Alabama's franchise tax scheme in the Circuit Court for Montgomery County. Certain of BellSouth's affiliates thereafter filed similar suits. One year later, petitioner CSX Transportation, Inc., and certain of its predecessors also separately brought actions, which, in the aggregate, sought declaratory relief and refunds with respect to tax years 1982 through 1991. After extensive discovery, the court conducted a two-day bench trial in December 1994.

At trial, petitioners sought to remedy the evidentiary deficiencies the Alabama Supreme Court had perceived in *Reynolds*. *First*, petitioners introduced an expert study proving the obvious: that Alabama corporations use their control over their stock's par value to reduce their taxes. The study compared the franchise tax that a random sample of domestic corporations actually paid with what they would have paid if they had been foreign corporations. *See* Statement 23-24, 29 (Pet. App. 35a-36a, 40a); *see also* J.A. 46-61, 62-65, 114-37.[4] The study showed that, on average, domestic corporations, if treated as foreign corporations, would have paid at least five times the amount they actually paid. *See* Statement 24 (Pet. App. 36a) (percentage of discrimination ranging from 409.56% in 1988 to 509.15% in 1991).[5]

Second, petitioners sought to rebut the *Reynolds* court's holding that the foreign franchise tax should be treated as "complementary" to the aggregate of the domestic franchise tax and the domestic shares tax. Petitioners argued that, as a matter of law, a different and unrelated tax like the shares tax could not qualify as an offsetting domestic burden sufficient to defeat a claim of unconstitutional discrimination. But they also showed that, as a matter of fact, the discrimination persists even when one takes full account of the domestic shares tax: the sampled domestic corporations, if treated as foreign corporations, would still have paid, on average, roughly twice as much in foreign franchise tax as they actually paid in domestic

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[4] As the trial court found, *see* note 1, *supra*, the study was based on a "valid statistical sample" of more than 1,000 domestic corporations, using source data provided by the Alabama Department of Revenue and employing "generally accepted valid statistical practice and procedures." Statement 22-23 & n.22 (Pet. App. 34a-35a).

[5] The evidence of discrimination was based on data for tax years 1988 through 1991. The parties stipulated that evidence for the tax years 1988 through 1991 is representative of the other tax years at issue (1982-87). *See* Stip. ¶ 66 (Pet. App. 62a).

franchise and domestic shares taxes combined. *See id.* at 25 (Pet. App. 36a-37a) (percentage of discrimination ranging from 109% in 1988 to 104% in 1991).

Respondents sought to counter this evidence by introducing a study of their own. Instead of analyzing the tax liability of domestic corporations treated "as if foreign," respondents' so-called "Petrillo Study" purported to analyze the tax liability of selected foreign corporations (namely, the BellSouth and CSX taxpayers) treated "as if domestic." *See* Br. in Opp., App. Respondents asserted that, according to their study, petitioners would have paid *more* (not less) in domestic franchise taxes than they had actually paid in foreign franchise taxes. The study, however, was based on the implausible assumption that, if out-of-state corporations were to reincorporate as Alabama corporations, they would maintain their existing capital structure and would not reduce the par value of their stock to minimize their Alabama tax liability.[6]

Rejecting the Petrillo study, the Circuit Court agreed with petitioners that they had accomplished their objective of filling the evidentiary gaps in the *Reynolds* record: "The Court finds that the Taxpayers' evidence in this action clearly and abundantly demonstrates that the franchise tax on foreign corporations discriminates against them for no other reason than the state of their incor-

[6] Besides being unrealistic, this assumption was at odds with undisputed trial testimony that, if petitioners were to reincorporate in Alabama, they would reduce the par value of their stock to minimize their franchise tax liability. *See* J.A. 102, 107; Tr. 279-80. The Petrillo study also suffered from additional flaws: it mistakenly treated as the par value of capital stock figures that some of the BellSouth taxpayers had in fact reported as their book value, *see* J.A. 98-104, 107-10, and it ignored a Georgia statute expressly fixing the par value of the BellSouth taxpayers at a penny, *see* J.A. 97-105.

poration." Pet. App. 21a-22a (footnote omitted).[7] The court also agreed with petitioners' legal arguments that this Court's recent decisions had thoroughly undermined the Alabama Supreme Court's reasoning in *Reynolds* by confirming both that there is no "de minimis" exception to the Commerce Clause's ban on discrimination against interstate commerce and that discrimination caused by one state tax (like Alabama's franchise tax) cannot be offset by an unrelated state tax (like the domestic shares tax):

> [T]he Court believes that since 1989, the United States Supreme Court has made it abundantly clear that a state's tax scheme cannot impose the slightest burden on interstate commerce unless there is some reason for doing so other than economic protectionism. *Oregon Waste Systems v. Department of Environmental Quality*, 511 U.S. [93], 114 S. Ct. 1395 (1994); *Associated Industries v. Lohman*, 511 U.S. [641], [114] S. Ct. [1815] (1994). In addition, the decision in *Fulton Corporation v. Faulkner*, [516] U.S. [325], 133 L.Ed.2d 796 (1996), enlightens the analysis of the complementary tax doctrine and appears to super[s]ede the reasoning of the *Reynolds* court.

Id. at 21a. The court therefore concluded "that the franchise tax on foreign corporations violates the commerce clause of the Federal Constitution." *Id.* at 22a.

Nevertheless, the Circuit Court entered judgment against petitioners. Referring to the earlier *Reynolds* litigation, the court said in a single unexplained sentence—for which it cited no authority—that, "based upon Alabama juris-

[7] The omitted footnote states: "See Taxpayers' brief filed May 17, 1994, pp. 10-39, which the Court finds to fairly state the evidence in this case and, except as otherwise indicated, the Court adopts as its own." Pet. App. 21a n.7. The portion of petitioners' trial court brief that the court adopted as its own is the "Statement of the Facts" reproduced at Pet. App. 23a-47a.

prudence, the Taxpayer's claims are barred by *res judicata*." *Id.* at 17a. The court so held even though none of the taxpayers was a party to the *Reynolds* litigation; none had an opportunity to present evidence or argument in the *Reynolds* litigation; none was in any way affiliated with the *Reynolds* plaintiffs; none had authorized them to represent its interests; none in any way controlled the prosecution of the *Reynolds* case or shared in the plaintiffs' legal expenses; and, indeed, none was even *aware* of the *Reynolds* litigation until after the trial court issued its decision in that case. *See* Tr. 131-32, 192-93 (Pet. App. 69a-70a, 73a-74a).

Having concluded that the taxpayers' claims were barred by state-law res judicata principles, the Circuit Court turned to the question whether denying the taxpayers their day in court would violate their federal due process rights. The court acknowledged that, in *Richards v. Jefferson County*, 517 U.S. 793 (1996), this Court had invalidated a similar application of res judicata. In *Richards*, the Alabama Supreme Court had held that a decision in a prior action brought by one set of taxpayers barred an action by a second, unrelated set of taxpayers on the theory that the first set of taxpayers "adequately represented" the second. *Id.* at 796. This Court reversed the Alabama Supreme Court's decision as an "extreme application of state-law res judicata principles" violative of due process. *Id.* at 804.

But the Circuit Court held that *Richards* was distinguishable on two grounds. *First*, the court believed that petitioners here, unlike the petitioners in *Richards*, could be said to have had "notice" of the prior litigation. Pet. App. 19a. The court used the term "notice," however, in a decidedly unorthodox manner: *not* to signify notice to non-parties that their rights might be adjudicated preclusively in pending litigation, but rather to signify merely a general *awareness* of the pending litigation—and even then an imputed rather than an actual awareness. The court stated that, because petitioners are "large and sophisticated corporations," it was reasonable to assume that they "are well informed in all matters involving issues of national and state taxation, and that they stay well informed of significant pending legal actions and court decisions." *Id.* at 18a. The court added that petitioners "admit[ted]" that, by the time they brought suit in this case, they had become aware of the trial-court decision in *Reynolds* and, in that sense, had acquired "actual notice" of that litigation. *See id.* at 18a-19a.

Second, the Circuit Court apparently concluded that it was more reasonable in this case than it had been in *Richards* to hold that unrelated taxpayers in the earlier case adequately represented taxpayers in the later case. The court noted that the "*Reynolds* taxpayers were represented by well known and excellent counsel"; that, even though "all of the precise arguments may not have been made in *Reynolds* that are presented to this Court, the *Reynolds* action and this action arise out of the same nucleus of operative facts"; that the taxpayers' basic Commerce Clause claim was "addressed and decided in *Reynolds*"; that "[t]here was not a significant lapse of time between the *Reynolds* litigation and these . . . actions"; that "[t]here is no conflict between the interests of the *Reynolds* taxpayers and the Taxpayers in this action"; and that petitioners were "represented by the same attorney." *Id.* at 19a.[8]

[8] The court was apparently referring to the fact that Professor Walter Hellerstein, co-counsel to petitioners in this case, also represented the *Reynolds* plaintiffs. The court failed to mention that Professor Hellerstein represented the *Reynolds* plaintiffs only in seeking review in this Court, and not in any state-court proceedings. The court also did not explain how Professor Hellerstein could have protected petitioners' interests in the *Reynolds* litigation, particularly when he did not become involved in the *Reynolds* litigation until after the purported evidentiary failure that the Alabama Supreme Court saw in *Reynolds* had already occurred.

b. Alabama Supreme Court. In their appeal to the Alabama Supreme Court, petitioners challenged the Circuit Court's res judicata determination and, among other things, reiterated their Commerce Clause objections to the franchise tax. Nearly a year after the case was submitted, the Alabama Supreme Court, in a five-to-four decision, issued an order that stated in full:

> PER CURIAM.
>
> AFFIRMED. NO OPINION.
>
> See Rule 53(a)(1) and (a)(2)(F), Ala. R. App. P., and *White v. Reynolds Metals Co.*, 558 So.2d 373 (Ala. 1989), cert. denied, *Reynolds Metals Co. v. Sizemore*, 496 U.S. 912 (1990).

711 So.2d at 1005 (Pet. App. 1a).[9]

Though there was thus no opinion for the court, one member of the majority (Justice Maddox) attempted in a concurring opinion "to explain why" the trial court's decision should be affirmed. *Id.* In Justice Maddox's view, the critical fact was a letter that counsel for South Central Bell sent to the Circuit Court in January 1990 (after the Alabama Supreme Court had issued its decision in *Reynolds*) requesting that the court hold the case in abeyance pending final disposition of the *Reynolds* litigation. *See* 711 So.2d at 1006 (Pet. App. 3a-4a). The letter stated:

> [B]oth the taxpayer and the State Department of Revenue desire that further proceedings with regard to this appeal be held in abeyance pending a final disposition of the *Reynolds* and [*GM*] cases, whether that be at the rehearing stage before the Alabama Supreme Court or by judicial review in the U.S. Supreme Court. However, if either party desires to proceed at a later date, with the Court's permission, this case would be activated.

Id.

[9] Rule 53(a) of the Alabama Rules of Appellate Procedure provides in pertinent part: "The Supreme Court . . . may affirm a judgment or order of a trial court without an opinion if the court determines: (1) That an opinion in the case would serve no significant precedential purpose; and (2) That . . . (F) [t]he court, after a review of the record and the contentions of the parties, concludes that the judgment or order was entered without an error of law." Pet. App. 108a.

Justice Maddox interpreted this routine abeyance request to mean "that both parties advised [the trial court] that they were going to be bound by the final decision in the *Reynolds Metals* case," 711 So.2d at 1006 (Pet. App. 4a); he therefore concluded that "the trial court did not err in holding that the decision in *Reynolds Metals* precluded the claims of these particular taxpayers," *id.* at 1007 (Pet. App. 6a). Justice Maddox gave no reason for inferring that a litigant waives the right to pursue its own case when it asks a court to hold its case in abeyance pending the disposition of another case. Nor did Justice Maddox explain how South Central Bell's action could bind the CSX taxpayers, who did not even file their lawsuits until a year after counsel for South Central Bell wrote the letter in question. And, as for this Court's decision in *Richards*, Justice Maddox observed without elaboration that "[t]he operative facts of this case relating to the Due Process Clause argument are . . . wholly different." *Id.*

In contrast, three of the four dissenting Justices joined an opinion by Justice See concluding that "the taxpayers' claims are not barred by the doctrine of res judicata." *Id.* (Pet. App. 7a).[10] The dissent observed that the doctrine simply does not apply where, as here, "we are dealing not only with different tax years, but also with different taxpayers." *Id.* at 1008 (Pet. App. 8a). The dissent further noted that "the doctrine of res judicata does not apply

[10] Justice Cook dissented without opinion.

when the judgment pleaded as an estoppel is based upon controlling decisions subsequently repudiated by supervening decisions." *Id.* That principle was applicable here, the dissent explained, because this Court "has rendered intervening decisions that repudiate the *Reynolds Metals* rationale." *Id.*

On the merits, the dissent found it "inescapable that the Alabama franchise tax scheme runs afoul of the design of the Constitution of the United States to make of this nation a single market." *Id.* (Pet. App. 7a). The dissent noted that the domestic franchise tax applies only "to the easily manipulable base of par value," whereas the foreign franchise tax applies "to the much larger base of par value plus other items such as surplus and long-term debt." *Id.* at 1010 (Pet. App. 12a-13a). Because "[i]t is not facially apparent" that the much greater foreign tax base "merely equalizes the burden produced by the application of" the higher tax rate applicable to domestic corporations (1% vs. 0.3%), the dissent found that "the Alabama franchise tax facially discriminates against interstate commerce." *Id.* Recognizing that this Court has rejected a "de minimis" exception to Commerce Clause principles, the dissent added that "arguments over the degree of the discrimination do not affect this characterization." *Id.* (Pet. App. 13a).

The dissent was also unpersuaded by the State's defense that the discriminatory foreign franchise tax could be justified as a "compensatory tax" for other levies imposed on domestic corporations. While acknowledging that the Alabama Supreme Court had "accepted a similar argument in *Reynolds Metals*," *id.* at 1011 (Pet. App. 13a), the dissent observed that this Court "has since clarified and narrowed the definition of compensatory tax," *id.* (citing *Fulton Corp. v. Faulkner*, 516 U.S. 325, 332-33 (1996), and *Oregon Waste Sys., Inc. v. Department of Environmental Quality*, 511 U.S. 93, 102 (1994)).

In particular, the dissent concluded that Alabama's franchise tax failed two of this Court's criteria for a permissible "compensatory tax." *First*, the dissent stated, the State had failed to demonstrate that the "discriminatory interstate tax . . . roughly approximates, but does not exceed," the taxes on intrastate commerce for which it allegedly compensates. *Id.* (Pet. App. 13a-14a). To the contrary, the dissent noted, "the Taxpayers offer substantial evidence supporting the proposition that the foreign franchise tax exceeds any intrastate burden." *Id.* (Pet. App. 14a). *Second*, the dissent concluded that "[t]he State also fail[ed] to show that the events taxed by Alabama's intrastate taxes and the interstate tax are 'substantially equivalent.'" *Id.* (citing *Fulton*, 516 U.S. at 333, 336-38). In contrast to sales and use taxes, which are complementary because they are functionally equivalent to one another, the foreign franchise tax (a tax on a corporation's privilege of doing business in Alabama) and the domestic shares tax (a tax on a shareholder's ownership of personal property) "cannot be viewed as 'mutually exclusive proxies' for each other." *Id.* (citing *Fulton*, 516 U.S. at 333, 338-40).

SUMMARY OF ARGUMENT

Whether treated as a Commerce Clause holding, a res judicata holding, or both, the Alabama Supreme Court's "no opinion" affirmance cannot be squared with controlling decisions of this Court.[11]

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[11] The Alabama Supreme Court's order merely cited the *Reynolds* decision and Rule 53(a)(1) and (2)(F) of the Alabama Rules of Appellate Procedure. Those references can be read to suggest either a ruling on the merits of petitioners' Commerce Clause claims, or a ruling based on res judicata, or both. The court may have believed that *Reynolds* (cited only as precedent) was still good law on the merits of petitioners' Commerce Clause challenge and may thus have concluded (in the words of Rule 53(a)(2)(F)) that the trial court's "judgment" (in the sense of its result) had been "entered without an error of law." Or the court may have believed that

First, this Court's decision in *Richards v. Jefferson County* squarely forecloses the use of res judicata to bar petitioners' actions. In *Richards*, the Alabama Supreme Court, invoking state-law res judicata principles, barred a federal constitutional challenge to a state tax on the transparently meritless theory that the taxpayer plaintiffs had been adequately represented by a group of different, unrelated taxpayers who had previously challenged the same tax unsuccessfully. In its decision unanimously reversing that judgment, this Court held that barring a taxpayer challenge on such a theory offends federal due process. That holding is equally applicable here.

The distinctions to which Justice Maddox and the trial court pointed are insubstantial. Contrary to Justice Maddox's belief, one petitioner's request that the trial court hold its case in abeyance pending final resolution of the *Reynolds* litigation cannot logically be read to suggest that the requesting petitioner—let alone any of the other petitioners—agreed to be bound by the outcome of the *Reynolds* litigation. Similarly, the trial court's conclusion that petitioners are bound because they had "notice" of the *Reynolds* litigation—in the sense that they knew of its existence—is not only factually incorrect but also legally meritless: a non-party's mere awareness of pending litigation neither satisfies the minimum notice requirements of due process nor justifies encumbering the non-party with the same preclusive consequences that burden

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Reynolds (cited as a preclusive prior judgment) foreclosed petitioners' current challenge on the basis of res judicata, and that the trial court's judgment (embodying that court's res judicata holding) should be affirmed for that reason. Or the court may have believed that the trial court's judgment should be affirmed on both Commerce Clause and res judicata grounds. In the absence of an opinion expressing the views of the majority, and believing that neither ground could justify the ruling in light of this Court's decisions, petitioners challenged the Alabama Supreme Court's judgment on both grounds, and this Court granted review on each.

an actual party to the litigation. And the trial court's determination that petitioners can properly be barred because they were "adequately represented" by the *Reynolds* plaintiffs, with whom they had no connection whatsoever, is in no meaningful way different from the theory this Court expressly rejected in *Richards*.

Second, in the words of the dissenting Justices below, "it is inescapable" that Alabama's franchise tax scheme violates the Commerce Clause. The State allows domestic corporations to diminish their franchise tax liability at will simply by reducing the par value of their stock. Because the State gives foreign corporations no such control over their franchise tax liability, Alabama's franchise tax facially discriminates against foreign corporations. And the tax demonstrably discriminates in practical effect: as the trial court found, the evidence in this case proves that Alabama corporations on average pay only about one-fifth the amount of franchise tax they would pay if they were foreign corporations.

Particularly in light of this Court's recent cases, Alabama's foreign franchise tax cannot be sustained as a permissible "complementary tax" needed to compensate for a related tax burden imposed disproportionately on domestic corporations. Even if one takes account of both the domestic franchise tax and the "domestic shares tax" (for which, in combination, the State claims the foreign franchise tax compensates), domestic corporations on average still pay only about half the amount of tax they would pay if they were foreign corporations. Furthermore, the domestic shares tax cannot properly be taken into account at all under this Court's "complementary tax" rulings because it is imposed on a "taxable event" altogether different from that of Alabama's foreign franchise tax: whereas the shares tax is an *ad valorem* tax on a shareholder's ownership of shares, measured by the value of those shares, the foreign franchise tax is an

excise tax on a corporation's privilege of doing business in Alabama, measured by its actual capital employed within the State.

Accordingly, this Court should remove both the res judicata and the Commerce Clause obstacles that Alabama has unjustifiably erected to block petitioners' claims, and it should remand for the fashioning of meaningful backward-looking relief.

ARGUMENT

I. ALABAMA'S EXTREME APPLICATION OF RES JUDICATA TO BAR PETITIONERS' CONSTITUTIONAL CHALLENGE VIOLATES THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT.

Under no plausible theory consistent with federal due process may Alabama invoke the judgment in the *Reynolds* case—to which petitioners were complete strangers—as a res judicata bar to petitioners' Commerce Clause challenge to Alabama's franchise tax scheme. The Alabama Supreme Court's judgment, to the extent that it relies on such extreme notions of res judicata, runs headlong into this Court's recent *Richards* decision.

1. In *Richards*, the Alabama Supreme Court held that a taxpayer's suit challenging an Alabama tax under the Due Process and Equal Protection Clauses of the Fourteenth Amendment was barred by res judicata in light of an earlier decision, *Bedingfield v. Jefferson County*, 527 So.2d 1270 (1988), in which that court had rejected a similar challenge to the same tax brought by different taxpayers. Even though the *Richards* plaintiffs had not been parties to the *Bedingfield* litigation, the Alabama Supreme Court held that they were bound by that decision. According to the Alabama Supreme Court, "the taxpayers in *Bedingfield* adequately represented [the taxpayers in *Richards*] because their respective interests

were essentially identical." 517 U.S. at 796 (internal quotation marks omitted).

This Court held that setting up *Bedingfield* as a bar denied the *Richards* plaintiffs their rights under the federal due process guarantee. *See id.* at 797. At the outset, the Court reiterated the bedrock principle that the Due Process Clause generally permits state courts to hold a litigant bound by an earlier decision only if that same litigant was a party to the earlier case. *See id.* at 797-98; *see also Hansberry v. Lee*, 311 U.S. 32, 40 (1940). The Court acknowledged that the rule may be different where, for example, there is a guardian-ward or trustee-beneficiary relationship, where there is a "class or representative sui[t]," or where there is "a special remedial scheme . . . as for example in bankruptcy or probate." 517 U.S. at 798-99 (internal quotation marks omitted). But no such exception applied in *Richards*.

And the Court rejected Alabama's argument that litigants may be bound whenever they were "adequately represented" in earlier litigation. *Id.* at 799-802. The Court called "troubling" the fact that the *Richards* plaintiffs had not been provided with "any notice that a suit was pending which would conclusively resolve their legal rights." *Id.* at 799. Moreover, the Court said, even assuming that "adequate representation" could ever "cure a lack of notice," the prior proceeding would "at least have to be so devised and applied as to insure that those present are of the same class as those absent and that the litigation is so conducted as to insure the full and fair consideration of the common issue." *Id.* at 801 (internal quotation marks omitted).

The *Bedingfield* proceeding, the Court held, simply did not anwer that description. The Court noted that the *Bedingfield* plaintiffs "did not sue on behalf of a class," that "their pleadings did not purport to assert any claim

against or on behalf of any nonparties," and that "the judgment they received did not purport to bind any county taxpayers who were nonparties." *Id.*[12] The Court therefore applied "the traditional rule that an extreme application of state-law res judicata principles violates the Federal Constitution." *Id.* at 804. The Court concluded that "[a] state court's freedom to rely on prior precedent in rejecting a litigant's claims does not afford it similar freedom to bind a litigant to a prior judgment to which he was not a party," and that this "general rule clearly applies when a taxpayer seeks a hearing to prevent the State from subjecting him to a levy in violation of the Federal Constitution." *Id.* at 805.

2. Using the *Reynolds* judgment to bar petitioners' claims is at least as "extreme [an] application of state-law res judicata principles" as was using the *Bedingfield* judgment to bar the claims in *Richards*, and it equally "violates the Federal Constitution." *Id.* at 804. As in *Richards*, none of the petitioners here was given notice that the *Reynolds* litigation "would conclusively resolve their legal rights." *Id.* at 799. Similarly, the *Reynolds* proceeding was not "so devised and applied as to insure that those present are of the same class as those absent and that the litigation is so conducted as to insure the full and fair consideration of the common issue." *Id.* at 801 (internal quotation marks omitted). Moreover, the *Reynolds* plaintiffs, like the *Bedingfield* plaintiffs, "did not sue on behalf of a class" or "purport to assert any claim . . . on behalf of any nonparties," and the *Reynolds*

[12] *See also* 517 U.S. at 802 ("Nor is there any reason to suppose that the individual taxpayers in *Bedingfield* understood their suit to be on behalf of absent county taxpayers. Thus, to contend that the plaintiffs in *Bedingfield* somehow represented petitioners, let alone represented them in a constitutionally adequate manner, would be to attribute to them a power that it cannot be said that they had assumed to exercise.") (internal quotation marks omitted).

judgment "did not purport to bind any . . . nonparties." *Id.*[13]

And there are no meaningful distinctions. Contrary to Justice Maddox's assertion, the letter in which South Central Bell (joined by the State Department of Revenue) asked the trial court to hold the litigation in abeyance in no way suggests that South Central Bell ever agreed, either expressly or by implication, to be bound by the *Reynolds* decision. Instead, the letter (reprinted at Pet. App. 65a-66a) was a routine effort to conserve the resources of the trial court and the parties: if this Court had granted review in *Reynolds* and had invalidated the tax on the slender record developed in that case, it would have been unnecessary for South Central Bell to develop the full record eventually assembled in this case.[14] And it is simply a mystery how South Central Bell's abeyance request can possibly be understood to foreclose the CSX taxpayers, who did not even *file* their actions until a year later. *See* 711 So.2d at 1007 (Pet. App. 5a).

Quite apart from the fact that nothing in the letter can plausibly be read to manifest any intention to bind the taxpayers to *Reynolds*, it is utterly unrealistic to impute such an intention. It would be odd enough for peti-

[13] So extreme is the application of res judicata in this case that, as explained by the dissenting opinion below, it conflicts with settled principles even under Alabama law—both because the *Reynolds* case involved tax years different from those at issue in this case and because intervening legal authority undermined the viability of the *Reynolds* judgment. *See* 711 So.2d at 1008 (Pet. App. 8a).

[14] This is precisely how the trial court—presumably in a much better position than Justice Maddox to gauge the parties' intentions—treated the letter: it in no way equated the request for abeyance with any commitment to be bound. After this Court denied certiorari in *Reynolds*, the trial court, without attaching any significance to the abeyance request, restored the case to the active docket, *see* J.A. 35, disposed of the State's motion for summary judgment, *see* Pet. App. 17a n.4, and conducted a full trial on the merits of petitioners' claims.

tioners voluntarily to bind themselves to the outcome of litigation to which they were not a party, waiving any opportunity to cure defects in the *Reynolds* record without any offsetting benefit. But the timing of the abeyance request would make this odder still. South Central Bell sent the abeyance letter *after* the Alabama Supreme Court had already rejected the *Reynolds* plaintiffs' challenges. It is inconceivable that any taxpayer would willingly have tied its fate to that of litigants who had already suffered defeat at the highest level of the Alabama court system.

The trial court's "distinctions" (not endorsed even by Justice Maddox) are equally insubstantial. As for the trial court's "notice" point, the undisputed record evidence shows that petitioners did not become aware of the *Reynolds* litigation until after the trial court's decision in that case. *See supra*, p. 12.[15] And it is neither realistic nor constitutionally tolerable to impute knowledge to petitioners merely because they are "large and sophisticated corporations." Pet. App. 18a. In any event, even if one assumed—contrary to the facts—that petitioners were aware of the pendency of the *Reynolds* litigation, mere "knowledge" of a lawsuit cannot be equated with "notice that a suit was pending which would conclusively resolve [petitioners'] legal rights." 517 U.S. at 799. As this Court stated in *Richards*, "[t]he general rule is that the law does not impose upon any person absolutely entitled to a hearing the burden of voluntary intervention in a suit to which he is a stranger." *Id.* at 800 n.5 (internal quotation marks and brackets omitted).

The trial court also suggested that the *Reynolds* plaintiffs "adequately represented" petitioners, noting that

[15] Binding petitioners to the outcome in the *Reynolds* case is thus particularly offensive. In *Reynolds*, the Alabama Supreme Court based its rejection of the plaintiffs' claims on evidentiary failure. By the time petitioners learned of the *Reynolds* litigation, that purported failure had already occurred.

accomplished attorneys represented the *Reynolds* plaintiffs; that *Reynolds* arose from the "same nucleus of operative facts"; that petitioners' basic claim was "addressed and decided in *Reynolds*"; that there was no "significant lapse of time" since *Reynolds*; that the *Reynolds* plaintiffs had no "conflict of interest" with petitioners; and that the same attorney who represented the *Reynolds* plaintiffs also represented petitioners. But this "adequate representation" theory is identical to that already rejected in *Richards*: with the possible exception of the overlap of attorneys, each of these considerations applied equally in *Richards*. And to say that "[t]axpayers are represented by the same attorney" as the *Reynolds* plaintiffs significantly overstates the case: Professor Hellerstein (one of petitioners' counsel) represented the *Reynolds* plaintiffs only as co-counsel in seeking certiorari in this Court. *See* note 8, *supra*. In any event, overlap of attorneys is both legally and logically irrelevant.[16]

In sum, *Richards* controls this case, and Alabama therefore may not, consistent with the Due Process Clause of the Fourteenth Amendment, invoke res judicata principles to bar petitioners' federal constitutional challenges to the State's franchise tax scheme.

II. BY TAXING FOREIGN CORPORATIONS MORE HEAVILY THAN DOMESTIC CORPORATIONS, ALABAMA'S FRANCHISE TAX SCHEME DISCRIMINATES AGAINST INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE.

There can be no serious debate about the proper resolution of the merits of this case: Alabama's franchise tax

[16] *See generally Collins v. E.I. DuPont de Nemours & Co.*, 34 F.3d 172, 178-79 (3d Cir. 1994) (Becker, J.) ("[t]he fact that the plaintiff's attorney took part in a prior, similar action is irrelevant unless there is evidence that the plaintiff was, through his or her attorney, actually participating in the prior suit").

violates the Commerce Clause, as every judge who expressly addressed the merits of this case has concluded.[17] Both on its face and in effect, Alabama's franchise tax plainly discriminates against out-of-state corporations, and no plausible argument can be made that the complementary tax doctrine excuses this discrimination.

1. Alabama's franchise tax scheme produces a textbook violation of the Commerce Clause by "favor[ing] domestic corporations over their foreign competitors." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 333 (1996). By imposing a tax on domestic corporations measured by the par or stated value of their capital stock, Alabama permits domestic corporations effectively to determine their own franchise-tax liability, a freedom that those corporations naturally use to reduce their franchise tax payments to a minimal amount. *See* Stip. ¶¶ 21-24 (Pet. App. 52a-53a). In contrast, by imposing a tax on foreign corporations measured by actual capital employed in the State, Alabama precludes foreign corporations from doing the same. *See* Stip. ¶¶ 25-26 (Pet. App. 53a). Thus, as the dissenting opinion below properly recognized, "the Alabama franchise tax facially discriminates against interstate commerce," 711 So.2d at 1010 (Pet. App. 12a), thereby triggering the "virtually *per se* rule of invalidity" that this Court applies to facially discriminatory taxes. *See, e.g., Camps Newfound/Owatonna, Inc. v. Town of*

[17] The trial judge found that the tax violated the Commerce Clause because "the Taxpayers' evidence in this action clearly and abundantly demonstrates that the franchise tax on foreign corporations discriminates against them for no other reason than the state of their incorporation." Pet. App. 21a-22a (footnote omitted). The three Alabama Supreme Court Justices who joined an opinion on the merits likewise concluded that "it is inescapable that the Alabama franchise tax scheme runs afoul of the design of the Constitution of the United States to make of this nation a single market." 711 So.2d at 1008 (Pet. App. 7a). And the deafening silence of the five Justices who voted to affirm may be the surest sign that Alabama's franchise tax scheme cannot be defended against Commerce Clause attack.

Harrison, 117 S. Ct. 1590, 1598 (1997) (striking down state property-tax exemption for charitable institutions that was limited to institutions serving principally state residents); *Fulton*, 516 U.S. at 331 (invalidating property tax on "intangibles" that taxed corporate stock only to the extent that the issuing corporation engaged in out-of-state activity); *Oregon Waste Sys., Inc. v. Department of Environmental Quality*, 511 U.S. 93, 100 (1994) (condemning tax on in-state disposal of out-of-state waste that was higher than tax on in-state disposal of in-state waste).

The facial discrimination that infects Alabama's taxing scheme is no less manifest merely because foreign and domestic corporations pay franchise taxes at different rates and on different bases. The essential nature of the discrimination that is apparent on the face of the statute is that Alabama law permits domestic corporations to pay a tax on a base of their own choosing while compelling foreign corporations to pay a tax on a base determined by their business activities in the State. It is simple logic that a tax, whatever its rate or base, always favors those who are free to determine their own tax liability over those who are not.

In any event, the discrimination that is plain on the face of Alabama's franchise tax statute is fully borne out in its application. As the trial court found, domestic corporations, if they had been incorporated in any other State, on average would have been saddled with a franchise tax burden more than five times greater than what they actually paid. *See* Statement 24 (Pet. App. 36a). The percentage of discrimination ranged from 409.56% in 1988 to 509.15% in 1991, with domestic corporations paying between $39 million and $46 million less in Alabama franchise tax than they would have paid had they been treated as foreign corporations. *See id.*[18] It follows

[18] Put another way, the effective tax rate for the average domestic corporation in 1988-1991 was less than $0.60 per $1,000 of capital employed in Alabama, whereas the effective tax rate for foreign

that Alabama's franchise tax "in its practical operation work[s] discrimination against interstate commerce," *Best & Co. v. Maxwell*, 311 U.S. 454, 456 (1940), and therefore violates the Commerce Clause prohibition on state taxes that have a "discriminatory effect," *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984).

The trial court's factual determination that petitioners "clearly and abundantly demonstrate[d]" that Alabama's "franchise tax on foreign corporations discriminates against them for no other reason than the state of their incorporation" (Pet. App. 21a-22a) is not impeached by respondents' "as if domestic" study, which supposedly revealed that petitioners would have paid more taxes as domestic corporations than they paid as foreign corporations. *See* Br. in Opp. 10, App. The substantial "as if domestic" tax that petitioners purportedly would have paid resulted only because petitioners, not being Alabama corporations, have never had any reason to assign an artificially low par value to their stock. If petitioners had incorporated in Alabama, they would obviously have had every reason to minimize the par value of their stock, *see* note 6, *supra*—just as Alabama corporations do as a matter of course, *see* Stip. ¶¶ 21-24 (Pet. App. 52a-53a); Statement 17 & n.20, 38 (Pet. App. 30a, 46a-47a); J.A. 76-77, 110-11. Respondents' study thus cannot be taken seriously: it inconsistently treats petitioners as if they *are* Alabama corporations, but not as if they *act like* Alabama corporations.

Nor is it any antidote to the patent discrimination in the Alabama taxing scheme that foreign corporations can avoid it "by reducing the capital they employ in Alabama," Br. in Opp. 12—*i.e.*, by limiting their business activities within the State. Forcing taxpayers to choose between subjecting themselves to a discriminatory tax or

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corporations in those years was $3.00 per $1,000 of capital employed in Alabama. *See* Statement 24-25 (Pet. App. 36a).

deploying their resources to avoid the exaction plainly "forecloses tax-neutral decisions" (*Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 331 (1977)), thereby undermining our national common market. This Court has specifically held that a victim's ability to circumvent discrimination by yielding to its illicit incentives cannot save an impermissibly discriminatory tax. *See Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Finance*, 505 U.S. 71, 78 (1992) (there is "no authority for the . . . proposition . . . that a tax that does discriminate against foreign commerce may be upheld if a taxpayer could avoid that discrimination by changing the domicile of the corporations through which it conducts its business").

2. In light of the clear discrimination worked by Alabama's franchise tax (both by its terms and in its effect), the only remaining question is whether the discriminatory levy may be rescued from constitutional attack on the theory—seized upon by the *Reynolds* court, *see* 558 So.2d at 386—that it is a so-called "complementary" or "compensatory" tax needed to offset some burden imposed disproportionately on intrastate commerce. The answer to that question, under this Court's decisions, is by now entirely free from doubt: the compensatory tax defense cannot save Alabama's discriminatory franchise tax from condemnation under the Commerce Clause.

This Court has observed that "use taxes on products purchased out of state are the only taxes we have upheld in recent memory under the compensatory tax doctrine." *Oregon Waste*, 511 U.S. at 105. And an unbroken line of decisions over the past two decades reflects the Court's "recent reluctance to recognize new categories of compensatory taxes." *Id.*; *see Fulton Corp. v. Faulkner*, 516 U.S. 325 (discriminatory intangible property tax not complementary to state corporate income tax); *Associated Indus. of Missouri v. Lohman*, 511 U.S. 641 (1994) (discriminatory statewide use tax not complementary to local sales

taxes); *Oregon Waste*, 511 U.S. 93 (discriminatory tax on in-state disposal of out-of-state waste not complementary to general taxes on intrastate commerce); *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266 (1987) (discriminatory flat taxes on out-of-state trucks not complementary to other taxes on in-state trucks); *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) (discriminatory tax on out-of-state wholesalers not complementary to tax on local manufacturers); *Maryland v. Louisiana*, 451 U.S. 725 (1981) (discriminatory use tax on natural gas not complementary to local severance tax).

In a series of decisions handed down after *Reynolds*, this Court has carefully delineated the scope of the compensatory tax doctrine, articulating three requirements that must be met before a court may excuse otherwise unconstitutional discrimination: (1) the State must identify an intrastate tax burden for which the discriminatory tax attempts to compensate; (2) the tax on interstate commerce must roughly approximate—but not exceed—the amount of the tax on intrastate commerce; and (3) the events on which the interstate and intrastate taxes are imposed must be "substantially equivalent," *i.e.*, they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other. *Oregon Waste*, 511 U.S. at 103; *Associated Indus.*, 511 U.S. at 648; *Fulton*, 516 U.S. at 332-33.

The State cannot tenably defend its foreign franchise tax under this test: even assuming for the sake of argument that the domestic shares tax could qualify as an intrastate tax burden for which the discriminatory franchise tax purports to compensate,[19] the State cannot satisfy

[19] Even this assumption is tenuous: there is no indication whatsoever that the Alabama legislature enacted the foreign franchise tax to balance any burden imposed by the domestic shares tax. That conclusion is reinforced by the fact that Alabama imposes a *foreign* shares tax that closely parallels the domestic shares tax. *See* Ala. Code § 40-11-1(b)(9). Like its domestic counterpart, the foreign

either of the latter two criteria. *First*, even if one takes account of the domestic shares tax, domestic corporations on average still pay in franchise tax and domestic shares tax combined only about half the amount they would pay in franchise tax alone if they were incorporated outside of Alabama. *See* Statement 25 (Pet. App. 36a-37a). The tax on interstate commerce therefore cannot "be shown roughly to approximate—but not exceed—the amount of the tax on intrastate commerce." *Oregon Waste*, 511 U.S. at 103. Rather, as in *Associated Industries*, "[t]he resulting disparity is incompatible with what [this Court has] termed the 'strict rule of equality adopted in [*Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937)].'" 511 U.S. at 649.

Second, the domestic shares tax and the foreign franchise tax are not imposed on substantially equivalent events. The shares tax is an *ad valorem* personal property tax (much like a property tax on real estate): it taxes a shareholder for the privilege of owning stock in an Alabama corporation, and it is measured by the value of those stock holdings. In contrast, the franchise tax is an excise tax: it taxes the corporation (not the shareholder) for the privilege of doing business in Alabama, and it is measured by the amount of capital employed in Alabama. *Compare* Ala. Code § 40-14-70 *with* Ala. Code § 40-14-41. Alabama thus imposes the two levies not only on different events, but also on different taxpayers and different tax bases. Accordingly, the foreign franchise tax and the domestic shares tax cannot be viewed as complementary because the two taxes are not "sufficiently similar in substance to serve as mutually exclusive proxies for each other." *Oregon Waste*, 511 U.S. at 103 (internal quotation marks and brackets omitted); *see also*

shares tax is an *ad valorem* tax imposed on shareholders (not corporations), and is collected by county governments (not the State). *See generally* Statement 22 (Pet. App. 34a). Thus, to the extent that there were any need to balance the domestic shares tax, the need would be fully met by the foreign shares tax.

Fulton, 516 U.S. at 340 n.6 ("incidence upon the same class of taxpayers is a necessary condition for a finding that two taxes are complementary").[20]

In sum, Alabama's franchise tax scheme—both facially and in effect—discriminates against interstate commerce, and the compensatory tax doctrine cannot save the scheme from invalidation under the Commerce Clause.

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[20] The Court therefore need not reach the related question whether the domestic franchise tax could qualify as "sufficiently similar in substance" to the foreign franchise tax even though it is both imposed on a different event and measured by a different base.

CONCLUSION

The judgment of the Alabama Supreme Court should be reversed. The case should be remanded for further proceedings, including the provision of meaningful backward-looking relief.[21]

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[21] *See Newsweek, Inc. v. Florida Dep't of Revenue*, 118 S. Ct. 904 (1998) (per curiam); *Reich v. Collins*, 513 U.S. 106 (1994); *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990).